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MACRO NEWS

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## MACRO UPDATE: BREXIT VOTE DELAY, FRENCH PROTESTS

### Berenberg Macro Flash

#### **BREXIT: A MESSY PATH TO A SOFTER BREXIT**

**That Theresa May has delayed the Brexit vote wastes precious time:** While it adds to near-term uncertainty, it does not raise the hard Brexit risk by much. May's deal only had a narrow chance of success on a first vote anyway. After nearly two years of negotiating a deal with the EU to try to pacify the Eurosceptic wing of her party, Prime Minister Theresa May is learning the hard way. There is no possible deal between the UK and the EU that respects the realities of international cooperation that can ever meet the fantasies of the Brexiteers in her party. The delay ultimately reflects the government's need to get parliamentary support for the Brexit outcome. Two thirds of Parliament is pro-EU or at least strongly in favour of a soft Brexit. In our view, we are seeing now the first stages of May's deal failing. While exacerbating near-term uncertainty, the delay could be a step on the way to an ultimately softer Brexit outcome. We still see only a 10% chance of a hard Brexit. For our Brexit probabilities – see [Hard Brexit risk down, Corbyn risk up](#).

**The EU is unlikely to budge on the backstop:** The most contentious issue of May's agreement is the so-called 'Irish backstop'. The backstop, if triggered, would keep Northern Ireland in the single market for goods – but not Britain – once the transitional period has ended if the UK and EU have not agreed to other terms of trade that keep the Irish border open. Because the UK would not have the ability to unilaterally withdraw from the backstop, Brexiteers and many Remainers within the Conservative Party reject the proposal. The 10 Northern Irish DUP (Democratic Unionist Party) MPs whom the Conservatives rely on for a 13 seat working majority in the House of Commons reject the backstop as it would involve a regulatory border down the Irish Sea – thereby splitting the internal UK market. If May could get the EU to drop the backstop, she would probably get the remainder of her deal through parliament. But this is very unlikely. Yesterday EU leaders, mostly notably Irish Prime Minister Leo Varadkar who has a de facto veto on the deal from the EU side, said renegotiation of the backstop was not possible. Expect EU leaders at a special Brexit meeting on Thursday, on the sidelines of the regular EU summit, to repeat this message. Without major changes to the backstop, the odds are stacked against May if and when she brings her deal back to parliament. Once May's has a clear answer later this week from the EU, she will be under pressure to bring the deal back to the house as soon as possible. We therefore still see a good chance that parliament will debate and vote on the deal at some point next week before it rises for Christmas on the 20<sup>th</sup> December.

**Getting tactics wrong again:** Unfortunately, May's tactics are not helping her at all. Today, she is flying to The Hague and Berlin to meet the Dutch prime minister and the German chancellor, trying to enlist their help in softening the EU position. As has often been the case over the last two years, the UK's diplomatic efforts are misdirected. To discuss the Irish backstop, May would have to spend the day in Dublin as Ireland is shaping the EU position on this one issue - which is of supreme national importance for Ireland.



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**Ready the confidence votes:** Following May's decision to postpone the vote on her deal, the Liberal Democrats, the Scottish National Party and Plaid Cymru all said they would back the Labour Party if it put forward a motion of no confidence in the Conservative-led Government. Labour leader Jeremy Corbyn has said he will wait for May's deal to fail before bringing such a vote to the house. Although a vote of no confidence would add to uncertainty, opposition party MPs are unlikely to fell the Government. For now, we expect Conservative and DUP MPs to stick together and see off any challenges from the opposition. However, even if the government is probably still safe for now, May's journey as Conservative leader and Prime Minister could soon be running out of road. If Conservative and DUP MPs believe that May is wasting the little remaining time running with a deal that is destined for failure they might see bringing her down is the only way to take her deal off the table to try a different option. 48 signatures from Conservative MPs are needed to trigger a confidence vote in the leader. A simple majority (158 MPs) would be needed to get rid of May.



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### FRANCE: MACRON TRIES TO STAY ON TRACK

**Mea culpa from Jupiter:** In an attempt to calm the "yellow vest" protests French President Emmanuel Macron said sorry yesterday (sort of). He acknowledged to the French that he had "offended some of you", did not react "quickly enough" and "sometimes I may have given you the impression that I had other priorities".

**Christmas presents:** Macron announced a number of measures including that the minimum wage (SMIC) will increase by €100 a month, overtime hours will be tax-free and not subject to social contributions, and the tax hike on pensions (CSG) will be reversed for those below 2,000 euros a month. He also asked businesses to pay an extra end-of-year bonus. Businesses will be compensated for the costs of the minimum wage increase, possibly by a wage subsidy. This is a policy shift with immediate impact. Prime Minister Edouard Philippe will follow up today with more details.

**Debt increasing:** Macron's sweeteners are coming at a cost. They add up to €10bn euros or slightly more, equivalent to 0.4% of GDP. On top of the already announced €4bn to cancel the fuel tax hike, this could push the 2019 deficit from 2.8% to 3.4% of GDP unless offset by savings, which will be difficult to find. France's debt-to-GDP will likely rise beyond 100% as a result. This could also complicate the current conflict between the EU and Italy. The key difference, though, is that France is cutting taxes and spending some money to get pro-growth supply-side reforms through. Italy is spending more money to do exactly the opposite.

**Macron is sticking to reform agenda:** The bad news is that Macron the reformer is facing these major and disruptive protests. He has turned from darling to fallen angel very quickly. Importantly, he is taking the right approach to address the protesters' concerns. He gives out hand-outs – which risks inflating the fiscal deficit – but does not backtrack his supply-side reforms. For example, he has not cancelled the change from a total wealth tax to a real-estate only wealth tax. He is turning France into a better place to do business. As long as he continues with pro-growth supply-side reforms, the French economy can strengthen over time despite a cyclical slowdown now. Of course, we now have to watch how much he may lose his ability to legislate additional pro-growth reforms beyond the ones he has already delivered.

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